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Member, Board of Governors of the Federal Reserve System

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Comments On Address by Milton Gilbert, Economic Adviser, Bank for International Settlements, Entitled "The International Monetary Problems of Today and Implications for the 1970's"

Mr. Chairman, I am in a rather awkward position today in commenting critically on Milton Gilbert's remarks because, as you know, I am a close personal friend of Milton's; I usually stay at his home in Basle whenever I go there for the monthly meetings of central bank Governors; and it would seem ungracious indeed for me to bite the hand that feeds me literally and liberally on those occasions. However, while I find much to commend in the first part of his remarks on the domestic side, I completely part company with Milton when he begins to talk about the international monetary system as a whole. His remarks are really a repeat of the many discussions I have had with him at his home in Basle. We normally shave at the same time in the morning, using a double sink, and while I am busy shaving the cheekbones, Milton frequently makes comments on the U. S. domestic scene that are both penetrating and sensible. But about the time I get around to the neck and throat area, he begins to declaim on his favorite fetish,* namely, gold and the gold price and I have to be very careful not to cut myself in the process of finishing a shave! And of course, when I finish, I repeat all the good and sufficient reasons why his is a "fetish" view. Parenthetically, this is actually an apocryphal story because by now we know each other's position so well, we no longer debate the issue.

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*The Webster dictionary definition of fetish is 1. Any object believed by primitive peoples to have magic power and 2. Anything held in unreasoning devotion.

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Turning first, however, to what I can agree with in Milton's remarks, I share his concern over worldwide inflation and its seeming intractability and unresponsiveness even to adequate demand management policies. And I agree that all too often too much of the burden of stabilization policy falls on the central bank. I agree too that fiscal policy matters as well as money. But I think that he overstates his case that wage inflation is the central issue for good and all in his diagnosis of the causes of inflation and whether a business cycle still exists. Here in the U. S. our demand management policies have clearly begun to pay off in terms of prices and inflationary expectations. It takes time, but ending excess demand in enough countries and particularly in the United States is already bringing some reinforcing cyclical reactions--and after wholesale prices will have leveled off and the consumer price rise will have slowed there will surely be some slowing of the wage rise at last; after that the problem will be to keep excess demand from beginning to develop again. Milton mentions in one sentence the rise of raw material prices as one of the international impulses to inflation. He fails to note that the peak of materials prices came early this year, initiating a period in which excess inventory demand gets dissipated and upward pressures on those prices disappear or get reversed. And with regard to business capital expenditures, it is clear by now that both in the United States and Germany the combination of tight money, the profit squeeze, and the subsiding

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of inflationary expectations is having a real effect in slowing the pace of new orders. Assuming that as an economist, Milton recognizes that in a sluggish economy a deficit caused primarily by a shortfall in revenues is appropriate, then I do not agree that in this year of our Lord 1970 the U. S. does not have a "firm fiscal situation," to use his terminology. Specifically, on a full employment budget basis, we are now moving into a surplus and anticipating an even more sizeable surplus in the first half of 1971.

Despite these comments, Milton seems to me to be on the right track as to the need for an incomes policy, not as a substitute for, but as a supplement to adequate demand management policies. In my remarks almost a year ago to the Lombard Association in London, I too raised the question, while Chairman Burns was even more explicit as to the possible useful role of an incomes policy in his remarks at Hot Springs, Virginia in May of this year and I share our Chairman's views on this matter. A la Milton, a study of the international transmission of inflation (frequently much exaggerated) also may be appropriate and I personally see no reason not to think through and explore possible ways of trying to supervise multilaterally the Euro-dollar markets although I have no specific suggestions at this point.

But when we come to the Milton Gilbert view of the international monetary system, the view with which I am only too familiar from our efforts at joint shaving, as I have indicated I part company completely. First of all, he mistakenly attributes the U. S. external deficit, i.e.,

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deficit in the balance of payments, to our unwillingness to revalue gold. In fact, a higher gold price would do nothing significant to bring about the necessary adjustment of the U. S. balance of payments away from deficit. There's no point in my trying to catalog all the reasons why a gold price change would be so fruitless. But I might just remind this audience of a few of the reasons cited by former Chairman Martin some time ago in his remarks titled "The Price of Gold Is Not The Problem:"

> "It can be taken for granted that a unilateral devaluation by the United States is impossible; a change in the price of gold in terms of dollars would undoubtedly be accompanied by an equal change in terms of virtually all other currencies.
>
> "Would the U. S. balance of payments improve as the result of such an increase in the price of gold? Only to the extent that the enlarged foreign exchange earnings of gold-producing countries led them to increase their purchases from the United States. But this would be a very small benefit compared with the magnitude of the U. S. payments deficit, and would be far outweighed by the many disadvantages that would accompany an increase in the gold price. Would American corporations have less incentive to invest abroad? Would Americans travel less? Would developing nations need less aid? Would our imports decrease? Would our military spending in Europe and Asia seem less pressing--if the price of gold were higher? The answer in each case is clearly no.
>
> 'Would European surpluses decline as the result of a higher gold price? Not at all. In fact, insofar as gold-producing nations increased their purchases from Europe, these surpluses would be aggravated.
>
> "It seems perfectly clear that a revaluation of gold would make little or no contribution to an adjustment of the imbalance in international payments."

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Second, and this again is not a new view on Milton's part, he labels the two-tier system "an anomaly" in the system and a potential source of trouble in the future. My own view is exactly the opposite. The two-tier system has already proved its durability and usefulness and as SDRs become an increasing proportion of total reserves, the price of gold in the commodity markets--even if one accepts the Gilbert projections of demand and supply relationships--seems to me to become more and more academic and uninteresting for monetary policymakers.

Third, he similarly inveighs against the SDR system which he opposed both in its conception and inception, and particularly against our use or nonuse of SDRs. He ignores the fact that we have, in fact, made use of SDRs and, as our Secretary of the Treasury pointed out in Copenhagen, stand ready to use any and all of our reserve assets. What grates on Milton's nerves is how anyone can view SDRs as such a good reserve asset as we do!

Fourth and finally, in the peroration of his remarks, he returns to the theme that a change in the gold price is an essential condition for reestablishing equilibrium of the system. But he never says <u>how</u> this would help the United States in adjusting its balance of payments and, as I have emphasized here today, it would not. Nor does he tell us how a higher gold price would help continental Europe move away from large and persistent surpluses. Just how would it encourage countries of continental Europe to find ways to export capital in amounts equal

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to their excess of exports over their imports of goods and services or, looking at it another way, how would it help them to reduce their export surpluses? The basic point, which Milton assumes away, is that a small change would neither be credible nor accomplish much of anything even if one made the heroic abstraction that it could be done unilaterally. Thus, an increase would have to be extremely large to be credible, otherwise everyone would simply expect any one change to be followed by another change in the price of gold. Yet it is difficult or even impossible to conceive of other countries standing still for a substantial change in the United States gold price. And if it were decisively large it would have a seriously inflationary potential impact with a great possibility of leading to the kinds of unmanageable inflationary problems that Milton spends much of his time talking about and against in the first part of his remarks. Of course, the distribution of gains would be inequitable and perverse in terms of gold-producing and holding countries. And while it means little to Milton, it would mean the death knell of the two-tier and SDR systems; in essence, it would be a retrogression from the system's evolving away from dependence on gold as a source of reserve growth toward a multilaterally-managed system based on SDRs. He simply fails to recognize that the creation of SDRs is much the better way of providing for the system's reserve growth and a favorable international environment for the adjustment process.

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To conclude Mr. Chairman, I would sum up briefly as follows:

I can find things to agree with in Milton Gilbert's remarks as to his abhorrence of inflation, his sense of the frustrations of a central banker, and his call for an incomes policy.

I am in complete disagreement with his old (and to me and others all too familiar) views regarding the gold price as the be-all and end-all of the problems of the international monetary system. I just do not accept his notion that this would do anything for the adjustment problem on either side of the water. From my own close familiarity with the U. S. problems on the side of stabilization policies and balance of payments programs, I do not believe a rise in the gold price is any alternative at all for our continued efforts to pursue the demand management policies that will keep our economy and its price level under control or at least under relatively better control than the rest of the world.

I know that Milton has never really accepted the SDRs as the good and growing part of world reserves that I am so certain they can and will be; and the establishment of the two-tier system must rankle one who was so sure we would have to turn to a change in the price of gold to add, irrationally, to liquidity. I conclude that the step he advocates could only be disruptive to the international monetary system and a step backward for the United States in its role of world leadership.

Finally, some time ago my friend Milton was asked to make a talk on "The World Economy" and, when he was preparing it, one of his friends said, "Well, at least, Milton, you can't stray off the subject!" I hope that I have made clear today that I think Milton has strayed off the subject of how to face the hard facts of life and how to make the hard decisions, both on the part of the surplus countries and deficit countries, to make the necessary adjustments that will make the international monetary system function even more effectively.

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